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APPLICATION OF

VIRGINIA-AMERICAN WATER COMPANY

CASE NO. PUE990677

For a general rate increase

REPORT OF ALEXANDER F. SKIRPAN, JR., HEARING EXAMINER

October 19, 2000

The parties have reached agreement on all of the issues in this case. Therefore, they submitted a Stipulation that, among other things, provides changes in rates which are designed to produce a total annual increase in revenues of \$857,832. The total is comprised of annual revenue increases for Alexandria and Hopewell of \$383,660 and \$549,359, respectively, and an annual revenue decrease for Prince William of \$75,187.

HISTORY OF THE CASE

On December 23, 1999, Virginia-American Water Company ("Virginia-American") completed an application for a general increase in rates. In its Application, Virginia-American requested an increase in rates, effective March 6, 2000, designed to increase annual operating revenues by \$1,441,570. Specifically, Virginia-American sought to increase annual operating revenues by \$675,019 for the Alexandria District, \$549,359 for the Hopewell District, and \$217,192 for the Prince William District. In addition, Virginia-American proposed a second increase of \$341,891 for the Hopewell District scheduled to take effect on March 6, 2001.

On February 3, 2000, the Commission issued its Order for Notice and Hearing in which it permitted the proposed rates to become effective March 6, 2000, subject to refund; directed Virginia-American to publish notice; established a procedural schedule; and assigned the matter to a Hearing Examiner. Furthermore, in its Order for Notice and Hearing, the Commission scheduled the matter for two public hearings. The Commission scheduled a public hearing on June 26, 2000, in Prince William County to accept public comments, and a public evidentiary hearing for July 12, 2000, in the Commission's Courtroom.

On February 10, 2000, Virginia-American filed a Motion for Change in Hearing Date, requesting that the Richmond hearing scheduled for July 12, 2000, be rescheduled to July 18, 2000. This motion was granted by a hearing examiner's ruling dated February 11, 2000. On May 22, 2000, Virginia-American filed a Motion for an Extension of Procedural Dates. Hearing Examiner's Ruling dated May 25, 2000, adopted a new procedural schedule, rescheduled the Richmond evidentiary

hearing for September 18, 2000, and retained the noticed hearing date of July 18, 2000, for the limited purpose of receiving testimony from public witnesses.

Protestants in this case included the City of Hopewell and the Hopewell Committee for Fair Water Rates (“Committee”).¹ Governmental officials filing comments with the Commission regarding Virginia-American’s request included John D. Jenkins, representing the Neabsco District on the Prince William County Board of Supervisors² and Kerry J. Donley, Mayor, City of Alexandria.³

On June 26, 2000, at 2:00 p.m., a public hearing was convened in the Board Chambers Room of the James J. McCoart Administration Building in Prince William, Virginia. Seven public witnesses, generally opposed to the proposed increase, appeared, including: (i) Edith Feigenbaum, (ii) James E. Perkins, (iii) Mary K. Hill,⁴ (iv) Kevin Raymond, (v) James Sawicki, (vi) John D. Jenkins,⁵ and (vii) Edgar B. Holley.⁶

On July 18, 2000, a hearing was convened as originally noticed for receiving comments from the public. No public witnesses appeared at this hearing.

On July 31, 2000, Virginia-American withdrew its requested second increase for the Hopewell District,⁷ due to unanticipated opposition from the City of Hopewell and the Committee.⁸ Moreover, Virginia-American stated that “[t]his action will necessitate another rate application in early 2001 to accomplish the inclusion of major plant facilities that are currently nearing completion.”⁹

On September 18, 2000, the evidentiary hearing was convened as scheduled. Representing Virginia-American at the hearing was Richard D. Gary, Esquire. Edward L. Flippen, Esquire, appeared on behalf of the City of Hopewell. Edward L. Petrini, Esquire, and Cliona M. Robb, Esquire, appeared as counsel to the Committee. Wayne N. Smith, Esquire, and M. Renae Carter, Esquire, represented the Staff. Filed with this Report are transcripts from each of the hearings.

¹ The Hopewell Committee for Fair Water Rates is comprised of: Cogentrix, Goldschmidt Chemical Company, Hercules Incorporated, Honeywell, Hopewell Cogeneration Facility, James River Cogeneration, PraxAir, Inc., and Smurfit-Stone Container.

² Letter dated February 11, 2000, Document Control Number 000230124.

³ Letter dated April 18, 2000, Document Control Number 000440162.

⁴ Coles Magisterial District Supervisor and vice-chairman of the Prince William County Board of Supervisors. Hill, Tr. at 11-12.

⁵ Neabsco District Supervisor on the Prince William County Board of Supervisors. Jenkins, Tr. at 23.

⁶ Member of the Prince William County Planning Commission. Holley, Tr. at 30.

⁷ Letter dated July 28, 2000, Document Control Number 000810017.

⁸ *Id.*

⁹ *Id.*

SUMMARY OF THE RECORD

In this case, Virginia-American calculated its requested increase in annual operating revenues based upon a test year encompassing the twelve months ended March 31, 1999.¹⁰ Virginia-American supported its request with the direct testimony of seven witnesses. Steven T. Edgemon, vice president and manager of Virginia-American, presented an overview of the need for this increase, a general description of Virginia-American's operations, information concerning the non-potable system for Hopewell, and changes to miscellaneous tariff fees.¹¹ James E. Salser, a self-employed rate consultant, provided support for Virginia-American's pro forma level of certain operations and maintenance expenses, depreciation expense, general tax and income taxes.¹² Mr. Salser also sponsored Virginia-American's rate base, capital structure, and the allocation between jurisdictional and non-jurisdictional customers.¹³ Frank J. Hanley, president of AUS Consultants-Utility Services, offered evidence regarding the cost of common equity for Virginia-American.¹⁴ John S. Watson, operations manager for the Hopewell District of Virginia-American, addressed Hopewell water treatment plant additions and costs associated with waste disposal expenses.¹⁵ William R. Walsh, operations manager for the Alexandria and Prince William Districts of Virginia-American, presented evidence concerning capital investments in his districts and concerning tank painting operations.¹⁶ Patrick L. Baryenbruch, president of Baryenbruch & Company, evaluated the services provided to Virginia-American by the American Water Works Service Company ("Service Company").¹⁷ Finally, John R. Palko, vice president of AUS Consultants-Utility Services, supported the jurisdictional cost of service study filed by Virginia-American in this case.¹⁸

On July 21, 2000, the City of Hopewell and the Committee each filed the testimony of one witness. The City of Hopewell filed the direct testimony of D. Wayne Trimble.¹⁹ Mr. Trimble expressed concerns over continued investments in facilities by Virginia-American to serve large industrial customers that may leave the system.²⁰ The Committee filed the direct testimony of Burnice C. Dooley, partner in the firm of Dooley & Vicars, Certified Public Accountants.²¹ Mr. Dooley offered several adjustments that, if adopted, would reduce the revenue requirement for the Hopewell District by \$227,344.²² Also, Mr. Dooley opposed Virginia-American's proposed second step increase.²³

¹⁰ Exhibit JES-3, at 5.

¹¹ Exhibit STE-2.

¹² Exhibit JES-3.

¹³ *Id.*

¹⁴ Exhibit FJH-4.

¹⁵ Exhibit JSW-5.

¹⁶ Exhibit WRW-6.

¹⁷ Exhibit PLB-7.

¹⁸ Exhibit JRP-8.

¹⁹ Exhibit DWT-13.

²⁰ *Id.*

²¹ Exhibit BCD-14.

²² *Id.* at 4.

On August 14, 2000, Staff filed its direct testimonies and exhibits. Patrick W. Carr, principal public utility accountant with the Division of Public Utility Accounting, provided several accounting adjustments and Staff's overall calculation of the revenue requirements for Virginia-American.²⁴ Based on the midpoint of Staff's recommended range of return on equity of 10.50%, Mr. Carr calculated the test year revenue deficiency of the Alexandria and Hopewell Districts to be \$292,039 and \$724,902, respectively.²⁵ Because Virginia-American requested an increase of only \$549,359, Staff limited its recommendation to that amount.²⁶ In addition, Mr. Carr found that current rates produced \$101,718 of excess revenues for the Prince William District.²⁷ Therefore, Mr. Carr recommended that rates be reduced for the Prince William District.²⁸

Mary E. Owens, principal financial analyst with the Division of Economics and Finance, addressed issues related to the appropriate capital structure, cost of equity, and overall cost of capital for Virginia-American.²⁹ More specifically, Ms. Owens found a cost of equity range for Virginia-American of 10.00% - 11.00%.³⁰ Based on a March 31, 2000, capital structure Ms. Owens calculated Virginia-American's cost of capital to range from 8.697% to 9.119%.³¹

Gregory L. Abbott, utilities analyst with the Division of Energy Regulation, presented his analysis of Virginia-American's jurisdictional separation study, class cost of service studies, class revenue apportionment, rate design, two-step rate increase proposal for the Hopewell District, miscellaneous service charges, and proposed changes to the rules and regulations section of Virginia-American's tariff.³²

On August 28, 2000, Virginia-American filed rebuttal testimony for four witnesses. Mr. Edgemon responded to questions about construction activities in Hopewell raised by City of Hopewell witness Trimble, the payroll adjustment proposed by Staff, the write-off of regulatory assets in the Prince William District proposed by Staff, and concerns regarding recent rate increases raised during the public hearings in Prince William County.³³ Mr. Watson presented the current status of each capital project in the Hopewell District, reviewed the reasons for the industrial non-potable water system, and disagreed with Committee witness Dooley's adjustment to wastewater treatment expenses.³⁴ Mr.

²³ *Id.* at 13-16.

²⁴ Exhibit PWC-15.

²⁵ *Id.* at 22; Exhibit PWC-15, at Statements IVA and IVB.

²⁶ Exhibit PWC-15, at 22-23.

²⁷ *Id.* at 23; Exhibit PWC-15, at Statement IVC.

²⁸ *Id.*

²⁹ Exhibit MEO-16.

³⁰ *Id.* at 1, 7-19.

³¹ *Id.* at 1-6.

³² Exhibit GLA-17.

³³ Exhibit STE-9.

³⁴ Exhibit JSW-10.

Hanley rebutted Staff's cost of equity recommendation by updating his earlier calculations to show that the current cost of equity for Virginia-American is within a range of 12.19% to 13.19%.³⁵ Mr. Salser addressed Staff's adjustments for capital structure, tank painting reserve, and payroll related expenses.³⁶

During the evidentiary hearing held on September 18, 2000, Virginia-American, Staff, and the Committee (collectively, "Stipulating Participants") offered a Stipulation settling all of the issues of this case.³⁷ The City of Hopewell, the only other protestant in the case, did not object to the Stipulation.³⁸ Pursuant to the Stipulation, all direct testimony and exhibits, and rebuttal testimony and exhibits were entered into the record, without cross-examination. Subject to agreed modifications, Virginia-American adopted Staff's adjustments and agreed to the following revenue changes:

Alexandria -- annual increase of \$383,660;
Hopewell -- annual increase of \$549,359; and
Prince William -- annual decrease of \$75,187.³⁹

These revenue changes are based on the midpoint of a cost of equity range of 10.25% to 11.25%, or an overall cost of capital of 9.014%.⁴⁰

Furthermore, although the Stipulating Participants agreed to Staff's earnings test results, regulatory asset write-off, and the use of such tests for Annual Informational Filings ("AIFs"), the earnings test shall have no precedential effect in future rate cases or subsequent AIFs.⁴¹ The Stipulating Participants agreed to tank painting reserve accruals of \$6,000 per month for November 3, 1997, through December 31, 1999.⁴² Beginning January 1, 2000, the annual reserve accrual should equal the average actual tank painting costs for the preceding five calendar years.⁴³

As to rate design, the Stipulating Participants agreed to Staff's modification of Virginia-American's rate design for Schedule 2 (non-potable service), for this case only.⁴⁴ This agreement is based on the understanding that such rates will have limited duration, and that Stipulating Participants and the City of Hopewell will address rate design issues subsequent to this case.⁴⁵

³⁵ Exhibit FJH-11.

³⁶ Exhibit JES-12.

³⁷ Exhibit Company-1.

³⁸ *Id.* at 5.

³⁹ *Id.* at 2.

⁴⁰ *Id.* at 3.

⁴¹ *Id.* at 2.

⁴² *Id.* at 3.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.* at 4.

Finally, the Stipulation concludes with the following language:

This Stipulation is conditioned on and subject to acceptance by the Commission and is non-severable and of no force and effect and may not be used for any purpose unless accepted in its entirety by the Commission, except that this paragraph shall be effective in any event.⁴⁶

DISCUSSION

Based on Virginia-American's application and based upon a review of the record, I find that the Stipulation offers a reasonable and just resolution to all of the issues in this case. Moreover, the Stipulation preserves certain issues related to the non-potable industrial system being installed in Hopewell for a future case where additional information should be available to facilitate resolution of these issues. Therefore, I find that the Stipulation should be adopted.

FINDINGS AND RECOMMENDATIONS

In conclusion, based on the Amended Stipulation and the other evidence received in this case, I find that:

- (1) The use of a test year ending March 31, 1999, is proper in this proceeding;
- (2) Virginia-American's test year operating revenues, after all adjustments, were \$27,407,573;
- (3) Virginia-American's test year operating revenue deductions, after all adjustments, were \$22,367,261;
- (4) Virginia-American's test year net operating income and adjusted net operating income, after all adjustments were \$5,040,312 and \$5,032,771, respectively;
- (5) Virginia-American's current rates produce a return on adjusted rate base of 7.936% and a return on equity of 8.133%;
- (6) Virginia-American's current cost of equity is within a range of 10.25% - 11.25%, and Virginia-American's rates should be established based on the 10.75% midpoint of the equity range;
- (7) Virginia-American's overall cost of capital, using the midpoint of the equity range and the capital structure as proposed by Staff and reflected in the Stipulation, is 9.014%;
- (8) Virginia-American's adjusted test year rate base is \$63,419,417;

⁴⁶ *Id.*

(9) Based on the Stipulation, Virginia-American requires \$857,832 in additional gross annual revenues to earn a reasonable return on rate base;

(10)The \$857,832 in additional gross annual revenues is assigned to Virginia-American's divisions as follows: Alexandria—an annual increase of \$383,660; Hopewell—an annual increase of \$549,359; and Prince William—an annual decrease of \$75,187;

(11)In accordance with the Stipulation, Staff's earnings test results and corresponding Prince William District regulatory asset write-off should be used for purposes of this case and all AIFs filed before Virginia-American's next rate filing. Such treatment shall have no precedential effect in future cases.

(12)Tank painting reserve accruals for November 3, 1997, through December 31, 1999, should be \$6,000 per month. Beginning January 1, 2000, such accruals should be equal to the average actual tank painting costs for the preceding five calendar years. The tank painting accrual reserve, net of tax, as of March 6, 2000, is \$135,639, and is assigned to Virginia-American's divisions as follows: Alexandria-\$46,361; Hopewell-\$49,137; and Prince William-\$40,141.

(13)Pursuant to the Stipulation, Staff's rate design is adopted for this case. The Stipulating Participants, in consultation with the City of Hopewell, will endeavor to address rate design issues, including the design of rates for non-potable service, prior to Virginia-American's next rate filing.

(14)The Company should file permanent rates designed to produce the revenues found reasonable herein using the revenue apportionment methodology agreed to in the Stipulation;

(15)The Company should be required to refund, with interest, all revenues collected under its interim rates in excess of the amount found just and reasonable herein;

In accordance with the above findings, ***I RECOMMEND*** that the Commission enter an order that:

1. ***ADOPTS*** the findings in this Report;
2. ***GRANTS*** the Company an increase in gross annual revenues of \$857,832;
3. ***DIRECTS*** the prompt refund of all amounts collected under interim rates in excess of the rate increase found just and reasonable herein; and
4. ***DISMISSES*** this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

COMMENTS

The parties are advised that pursuant to Rule 5:16(e) of the Commission's Rules of Practice and Procedure,⁴⁷ any comments to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen copies, within fifteen days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P. O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document that copies have been mailed or delivered to all other counsel of record and to any party not represented by counsel.

Respectfully submitted,

Alexander F. Skirpan, Jr.
Hearing Examiner

⁴⁷ 5 VAC 5-10-420 F.